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September 4, 2005

BY E-FILE AND OVERNIGHT DELIVERY

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, MA 02110

Re: Bay State Gas Company, D.T.E. 05-48

Dear Ms. Cottrell:

Enclosed for filing, on behalf of Bay State Gas Company ("Bay State"), please find an original and four (4) copies of the Bay State's Initial Brief, in the above referenced docket.

Please do not hesitate to telephone me with any questions whatsoever.

Very truly yours,

Patricia M. French

cc: John Geary, Hearing Officer
Andreas Thanos, DTE
Rebecca Hanson, DTE
Elizabeth Jackson, DTE
Joseph Rogers, Asst. Attorney General

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

INITIAL BRIEF OF BAY STATE GAS COMPANY

D.T.E. 05-48

REQUEST FOR APPROVAL OF TRANSCANADA GAS / UNION GAS CAPACITY REPLACEMENT AGREEMENTS

October 4, 2005

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I. INTRODUCTION

On July 13, 2005, Bay State Gas Company ("Bay State") filed its petition with the Department of Telecommunications and Energy ("Department") for approval of a Firm Transportation and Related Agreements with TransCanada Pipelines Limited ("TransCanada") and Union Gas Limited ("Union"). Bay State seeks approval by November 1, 2005.

On August 16, 2005, following notice duly provided, the Department held a procedural conference at its offices in Boston. KeySpan Energy Services – New England filed for, and was granted, limited participant status in the proceeding. The Attorney General sought and was granted intervenor status as of right. Discovery took place and on September 27, 2005, Bay State moved for the admission of its Petition (Exh. BSG-1), the direct prefiled testimony and exhibits of F. Chico DaFonte,[1] its responses to the Department's first set of information requests (Exh. DTE-1-1 through Exh. DTE-1-8), its responses to the Department's second set of information requests (Exh. DTE-2-1 through

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[1] Exh. BSG-1 is Mr. DaFonte's prefiled testimony and Exh. FCD-1 through Exh. FCD-14. These are: the ANE Agency Agreement for the Union and TransCanada 2006 Transportation Agreements (Exh. FCD-1), the Financial Backstopping Agreement between Union and Bay State (Exh. FCD-2), the Firm Transportation Contract (Dawn to Parkway) between Union and Bay State, dated February 25, 2005 (Exh. FCD-3), the Precedent Agreement between TransCanada and Bay State, dated February 11, 2005 (Exh. FCD-4), Shared Cost Event of Cancellation Agreement (Exh. FCD-5 CONFIDENTIAL), the Financial Assurances Agreement between TransCanada and Bay State, dated February 11, 2005 (Exh. FCD-6), the notification to marketers that Bay State faced a decision with regard to replacement capacity (Exh. FCD-7), a table demonstrating the Monthly Average Basis from Henry Hub to Dawn and Waddington (Exh. FCD-8), a table showing the Demand Cost at Various Load Factors (Long Haul vs. Short Haul) (Exh. FCD-9), SENDOUT Analysis (Exh. FCD-10 CONFIDENTIAL), Comparative SENDOUT Analysis (Exh. FCD-11 CONFIDENTIAL), SENDOUT Analysis (Exh. FCD-12 CONFIDENTIAL), Bay State's listing of Evaluation of Non-Price Elements for Resources Selection (Exh. FCD-13), Standards for Ranking of Selection on the Basis of Price and Non-Price Criteria (Exh. FCD-14).

Exh. DTE-2-9), and its responses to the Attorney General's first set of information requests (Exh. AG-1-1 through Exh. AG-1-28).

As part of its initial filing, Bay State asked the Department to grant protective treatment over certain selected pages of prefiled testimony, Exh. FCD-5 (Shared Cost Event of Cancellation Agreement), and Exhs. 10, 11, 12, the price and volumes information that Bay State provided in its SENDOUT model. The Department granted Bay State's requests for protection. Tr. 9/27/05.

II. DESCRIPTION OF RENEWAL PROJECT

The genesis of the Renewal Project dates back to 1986, when the Alberta Northeast Gas Ltd. ("ANE") consortium was formed to support regional efforts to secure incremental Canadian gas supply and associated transportation services ("original ANE Project"). Exh. BSG-1 at 5-6.[2] Bay State was not a participant in the original ANE Project because it had its own long-term supply contract at Waddington, NY, which has since expired. Exh. BSG-1 at 6.

The consortium imports 357.1 MMcf/d at the US/Canadian border. Exh. BSG-1 at 6. The Renewal Project was formed to address the recontracting strategy associated with the original ANE contracts, which are set to expire on October 31, 2006 and 2007. [3]

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[2] Northeast Gas Markets ("NEGM"), under a Management Service Agreement, provides all day-to-day management of ANE including nominations/operations support, treasury/invoicing functions, renegotiation of contract terms and assistance with regulatory matters. Id.

[3] The LDC Participants In The Renewal Project Are: Bay State (NiSource), Central Hudson Gas & Electric, Connecticut Natural Gas Corporation, Keyspan Energy Delivery of New England

Ultimately the group decided that the Dawn, Ontario hub ("Dawn") was the best option available for a variety of reasons including the liquidity at Dawn (many buyers and sellers along with a high volume of transactions), the stable basis between Dawn and Henry Hub (less price volatility compared to Waddington and points east), the six different pipeline feeds from multiple supply basins, the access to storage in Ontario and Michigan, and lower demand charges relative to TransCanada long haul. Exh. BSG-1 at 7.

III. DESCRIPTION OF AGREEMENTS

The key agreements in this matter are a Firm Transportation Contract and Financial Backstopping Agreement (together "the Union Agreements") between Bay State and Union Gas Limited ("Union") and a Precedent Agreement, Shared Cost Event of Cancellation Agreement and Financial Assurances Agreement (collectively, "the TransCanada Agreements") between Bay State and TransCanada Pipelines Limited ("TransCanada") for capacity to allow Bay State to access less costly pipeline and storage supplies at the Dawn trading Hub in Ontario, Canada. In addition, Bay State has also entered into an Agency Agreement with ANE. Exh. BSG-1 at 3.

(Boston Gas Company, Colonial Gas Company, Essex Gas Company snd Energy North Natural Gas Inc.), Keyspan Energy Delivery of New York, Keyspan Energy Delivery of Long Island, National Fuel Gas Distribution Corporation, Northern Utilities (NiSource), Southern Connecticut Gas and Yankee Gas Services Company.

ANE will act as administrative agent for Bay State with respect to the Union Agreements and the TransCanada Agreements through October 31, 2006. Exh . BSG-1 at 8; Exh. BSG-1 at Exh. FCD-1. Bay State will contract with Union for incremental mainline capacity pursuant to the recourse rate under Union's rate schedule M12 for a term of eleven (11) years commencing on or about November 1, 2006, or as soon thereafter as all required facilities are constructed. Exh. BSG-1 at 8; Exh. BSG-1 at Exh. FCD-2; Exh. BSG-1 at Exh. FCD-3. The maximum daily quantity ("MDQ") under this agreement is 27,803 GJ or 26,352 Dth and will have a primary receipt point at Dawn and a primary delivery point at Union's interconnect with the facilities of TransCanada at Parkway. Id. Bay State will contract with TransCanada for incremental mainline capacity pursuant to its Firm Transportation Service Toll Schedule for a term of ten (10) years commencing on or about November 1, 2006, or as soon thereafter as all required facilities are constructed. Exh. BSG-1 at 8; Exh. BSG-1 at Exh. FCD-5 CONFIDENTIAL; Exh. BSG-1 at Exh. FCD-6. The MDQ under this agreement is 27,498 GJ or 26,063 Dth and will have a primary receipt point at TransCanada's interconnect with the facilities of Union at Parkway and a primary delivery point at TransCanada's interconnect with the facilities of Iroquois Gas Transmission at Waddington, NY. Id.

As the Department is aware, precedent agreements or firm transportation contracts with conditions precedent are commonly used by pipelines and their customers to set forth the principle terms of their agreement and to establish any special requirements during the interim period before service begins. See, Exh. BSG-1 at Exh. FCD-4. Once the conditions have been satisfied, or waived if permitted under the agreements, the parties are either (1) required to enter into a firm transportation service contract, in the case of TransCanada, or (2) become governed by the terms set forth in the Firm Transportation Contract, in the case of Union. Exh. BSG-1 at 9; Exh. BSG-1 at Exh. FCD-4; Exh. BSG-1 at Exh. FCD-2.

Under the Union Firm Transportation Contract ("Union Contract"), a Shipper is exposed to financial liability only if it fails to satisfy or waive conditions for which it has some ability to affect the outcome. Exh. BSG-1 at 10. Thus if, by November 1, 2005, a Shipper has neither satisfied or waived the conditions to (i) enter into the necessary contracts with the Union and others to facilitate the Transportation Services contemplated in the Union Contract, and (ii) obtain all internal and external approvals or authorizations for the gas under the Union Contract ((i) and (ii) are collectively the "Listed Conditions"), then the Union Contract may be terminated. Exh. BSG-1 at 10-11. The Shipper may be subject to liability under the Union Financial Backstopping Agreement ("Union FBA"). Exh. BSG-1 at Exh. FCD-2.

Under the TransCanada Precedent Agreement ("Precedent Agreement"), the Shipper bears financial risks upon an Event of Cancellation. Exh. BSG-1 at 12; Exh. BSG-1 at Exh. FCD-4. Those financial risks vary depending upon the type of Event of Cancellation. In all cases, TransCanada is obligated to use commercially reasonable efforts to minimize Shipper's exposure to financial risks. Exh. BSG-1 at 12; Exh. BSG-1 at Exh. FCD-4. In the event of a Shared Event of Cancellation, a different formula applies. Exh. BSG-1 at FCD-5 CONFIDENTIAL .

As with other pipeline projects, the project sponsors seek financial assurances that the shippers will remain committed to the projects so that the pipelines are able to proceed to obtain favorable terms on project financing and complete pre-engineering and limited construction. Bay State compared the benefits, in the form of gas cost savings to its customers against the likelihood that costs would be incurred under the agreement and the exposure in such an instance, and determined it was reasonable to proceed. Exh. BSG-1 at 16-18.

IV. STANDARD OF REVIEW

The Department applies a public interest standard for approval of replacement capacity resources under G.L. c. 164, sec. 94A. Commonwealth Gas Co., D.P.U. 94-174-A at 27 (1996); Bay State Gas Co, D.T.E. 02-52 at 7 (2002). In order to make the requisite demonstration that the acquisition is in the public interest, the local distribution company ("LDC") must show the acquisition to be consistent with portfolio objectives and that the selected resource compares favorably with a range of alternative options reasonably available to the LDC and its customers, at the time the acquisition is made. Id. In the present case, Bay State's Union and TransCanada replacement acquisition satisfies these criteria and accordingly, Bay State requests that the capacity resources described in this filing be approved.

V. BAY STATE'S PRECEDENT AGREEMENT AND RELATED LETTER AGREEMENT ARE IN THE PUBLIC INTEREST AND SHOULD BE APPROVED

A. THE ACQUISITION IS CONSISTENT WITH BAY STATE'S PORTFOLIO OBJECTIVES

When determining whether a resource provides a consistent fit with a regulated company's portfolio objectives, the Department looks to recently approved portfolio objectives from the company's most recent resource plan or recent review of supply contracts, relying as well upon the company's description of its objectives in seeking the proposed resource. See, Commonwealth Gas Co., D.T.E. 94-174-A at 27; see Fitchburg Gas and Elec. Light Co., D.T.E. 02-55 at 3.

As Mr. DaFonte testified, the replacement of capacity with the TransCanada and Union resource contributes to Bay State's goal of developing a best-cost portfolio. Exh. BSG-1 at 23-28, 30. Bay State's planning process seeks to acquire and manage resources in a manner that achieves a best-cost resource portfolio for its customers, thereby balancing cost with non-cost criteria such as reliability, flexibility and viability. Exh. BSG-1 at 30. Ultimately, the goal of a best-cost portfolio is to achieve adequate and reliable service at a reasonable cost. See, Exh. BSG-2 at 30-31.

As Bay State reviews its portfolio, it seeks to satisfy these objectives: (1) to reduce portfolio cost; (2) to maintain portfolio reliability (which includes enhancing diversity in both transportation and supply); (3) to provide flexibility necessary for Bay State to respond to demands on its system; and (4) to acquire viable resources. Exh.

BSG-1 at 21. In selecting the instant replacement capacity among other alternatives, Bay State employed its resource planning process, analytical tools and assessment methods to perform long-range planning and evaluation and resource adequacy: it determined that customer requirements indicated increased design demand, tested the criteria, and measured its existing resource adequacy. Exh. BSG-1 at 21; Exh. BSG-1 at Exh. FCD-9; Exh. BSG-1 at Exh. FCD-10 CONFIDENTIAL; Exh. BSG-1 at Exh. FCD-11 CONFIDENTIAL; Exh. BSG-1 at Exh. FCD-12 CONFIDENTIAL.

Then Bay State conducted its resource evaluation, testing the need by using the SENDOUT® optimization model ("SENDOUT®") based on its current requirements forecast. Exh. BSG-1 at 21, 23-29; Exh. BSG-1 at Exh. FCD-10 CONFIDENTIAL; Exh. BSG-1 at Exh. FCD-11 CONFIDENTIAL; Exh. BSG-1 at Exh. FCD-12 CONFIDENTIAL. In order to use SENDOUT®, Bay State identified potential resources to meet its requirements including renewal or restructuring of existing resources as well as potential new pipeline, storage, citygate and on-system resources.[4] Id.

As Mr. DaFonte testified, Bay State's resource evaluation encompassed the assessment of both the cost and non-cost characteristics of potential resources. Id. The SENDOUT® cost analysis evaluates the impact of cost changes on Bay State's portfolio by simulating the daily dispatch of available resources under specified conditions. Exh.

[4] Bay State notifies retail suppliers of material changes to its portfolio that would affect the quantity and type of capacity assigned to third-party customer pools under the Department's existing capacity assignment regulations. Exh. BSG-1 at 23; Exh. BSG-1 at Exh. FCD-7.

BSG-2 at 12-13. SENDOUT® can evaluate a least-cost incremental resource or package of resources based on the total cost impact upon the existing portfolio. Id. Because SENDOUT® is just one evaluative tool, Mr. DaFonte testified that Bay State evaluates the non-cost characteristics of alternative resources including reliability, flexibility and viability through assessment techniques, including scoring. Exh. BSG-2 at 13.

The Department has reviewed Bay State's planning objectives and methods in the context of periodic Integrated Resource Plan ("IRP") proceedings, as well as in conjunction with previous requests for approval of specific resource decisions. See, e.g. Bay State Gas Co., D.T.E. 02-75 (2004); Bay State Gas Co., D.T.E. 03-32 (2003); Bay State Gas Co, D.T.E. 02-52 (2002); Bay State Gas Co., D.T.E. 00-52 (2000). Bay State has consistently followed the approved path of creating a "best cost" portfolio. See, e.g., Bay State Gas Co., D.P.U. 93-129 (1996) at 49. Bay State has consistently applied those methods to this resource selection. See, Bay State Gas Co., D.T.E. 03-32 (2003); Bay State Gas Co., D.T.E. 03-37 (2003). Since the Department previously determined that Bay State's portfolio objectives and its resource acquisition process were appropriate and reasonable, and since those techniques were followed here, the first criteria has been satisfied for the Department to find the replacement resource consistent with the public interest.

B. THE REPLACEMENT CAPACITY COMPARES FAVORABLY TO THE RANGE OF AVAILABLE ALTERNATIVES AT THE TIME

Bay State performed detailed cost simulations using SENDOUT® over an eleven-year period beginning November 1, 2006. Exh. BSG-1 at 25. An eleven-year period was utilized because some of the alternatives evaluated include incremental pipeline capacity having a minimum term of eleven years, which is consistent with the contract terms presently offered for capacity on new pipeline projects. Exh. BSG-1 at 25.

SENDOUT® was utilized first to determine the optimal amount of incremental capacity that would be required given the long haul and short haul capacity alternatives. Exh. BSG-1 at 25. This comparison was done by utilizing SENDOUT®'s resource mix analysis, which selects the optimal amount of capacity for each alternative over the eleven-year planning period. Exh. BSG-1 at 25. SENDOUT® selected 100% (26,063 Dth per day) of the available MDQ associated with the Union – TransCanada short haul capacity alternative compared to less than 1,000 Dth per day for the TransCanada long haul alternative. Exh. BSG-1 at Exh. FCD-10 CONFIDENTIAL, p. 37.

SENDOUT® was next asked to compare the Union – TransCanada alternative to the existing border purchase alternative at Waddington by calculating the total portfolio cost under each alternative. Exh. BSG-1 at 25-26. The SENDOUT® analysis concluded that the Union and TransCanada alternative is a cost-effective resource and would contribute to a lower total cost portfolio. Exh. BSG-1 at 26. SENDOUT showed a Waddington border "Grand Total" system cost of $3,723,830.71 ($000's) while its analysis of the Union-TransCanada alternative showed a "Grand Total" system cost of $3,713,933.07 ($000's). Compare, Exh. BSG-1 at Exh. FCD-11 CONFIDENTIAL at 32 (Waddington Border alternative) with Exh. BSG-1 at Exh. FCD-12 CONFIDENTIAL (Union-TransCanada alternative). The resulting portfolio savings over the eleven-year period from the Union – TransCanada alternative is approximately $9,897,640. Exh. BSG-1 at 26.

With regard to non-cost factors, Bay State typically evaluates a range of alternatives being considered based on the key factors of reliability, flexibility and viability. Exh. BSG-1 at 26-27. Reliability includes such factors as the supplier's reserves, delivery point capabilities and contractual protections in case of curtailment situations. Id. Flexibility includes such factors as minimum take provisions, nomination flexibility and access to storage. Id. Viability includes such factors as financial integrity, reputation and contribution to portfolio diversity. Id., see also Exh. BSG-1 at Exh. FCD-13. The non-cost summary demonstrates that the Union - TransCanada alternative is superior in virtually all categories evaluated. Exh. BSG-1 at Exh. FCD-14. The Waddington border option does not offer the same degree of reliability and flexibility as do the short haul and long haul alternatives due to the lack of suppliers at the Waddington point and the lack of storage. Exh. BSG-1 at 27; Exh. BSG-1 at Exh. FCD-14. The long haul alternative, while providing access to numerous suppliers at the AECO Hub, does not provide the same level of flexibility afforded at Dawn due to its lack of access to storage. The Union – TransCanada short haul alternative provides the necessary liquidity at the Dawn hub including access to flexible Union and Michigan storage. Id.

Moreover, Dawn provides Bay State with further supply diversity in its portfolio via access to seven upstream pipelines accessing supplies from Canada, the Midwest, the Gulf Coast, the Permian Basin and the Rockies. Exh. BSG-1 at Exh. FCD-14; Exh. BSG-1 at 27. The analysis demonstrated that the Union – TransCanada alternative contributed the most to portfolio diversity and was given the highest score. Id. Flexibility is scored according to various criteria with a 20-point maximum score. Exh. BSG-1 at 28. The Union – TransCanada alternative offered the most flexibility by providing direct access to multiple storage options. Assuming all other criteria being equal since no supplier has yet been selected at any of the delivery locations, the Union – TransCanada option received the highest possible score based on its access to storage. Exh. BSG-1 at 28-29.

Based on this analysis, Bay State concluded that the Union - TransCanada alternative is clearly the superior alternative available to Bay State at the present time from a cost and a non-cost perspective, offering superior flexibility via access to storage and enhanced diversity of supply. Exh. BSG-1 at 29.

VI. CONCLUSION

Bay State employed the Department-approved resource evaluation process to identify the Union and TransCanada replacement capacity as the superior alternative available to Bay State. The combination capacity route is preferable to the alternatives and offers superior reliability, diversity and flexibility.

WHEREFORE, for all the reasons set forth in this Initial Brief, Bay State Gas Company respectfully requests that the Department of Telecommunications and Energy grant its approval, pursuant to G.L. c. 164, sec. 94A, of the replacement capacity and agreements reflecting Bay State's acquisition of that capacity, as contained in this filing as Exh. FCD-1 through Exh. FCD-6, as consistent with the public interest.

Respectfully submitted,

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By its Attorney,

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DATED: October 4, 2005